Office - Supreme Court, U.S.
FILED
OCT 26 1982

No. 82-469

In the Supreme Court of the United States

OCTOBER TERM, 1982

CAROLYN C. FIKE, EXECUTRIX OF THE ESTATE OF ERNEST D. SKAGGS, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

REX E. LEE
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 633-2217

TABLE OF AUTHORITIES

Page

Cases:

Austin v. *United States*, 461 F.2d 733 4

Baker Commodities, Inc. v. *Commissioner*, 415 F.2d 519, cert. denied, 397 U.S. 988 4

Bishop v. *Commissioner*, 152 F.2d 389 6

Burnet v. *Harmel*, 287 U.S. 103 5

Commissioner v. *Estate of Bosch*, 387 U.S. 456 6

Haines v. *United States*, 76-1 U.S. Tax Cas. para. 9222 4

Keyes v. *Hurlbert*, 43 Cal. App. 2d 497, 111 P.2d 447 6

Michigan Trust Co. v. *Kavanagh*, 284 F.2d 502 6

Statutes and regulations:

Internal Revenue Code of 1954 (26 U.S.C.):

Sections 701-761 5
Section 708 ..... 4, 5
Section 708(b)(1)(A) 4
Section 743 3
Section 743(a) 3
Section 754 ..... 2, 3, 6
Section 1014 ..... 1, 2, 3
Section 1014(a) 3
Section 1014(b)(6) 3

Page

Statutes and regulations—Continued:

Cal. Civ. Code § 5125 (West 1970 & Cum. Supp. 1982) 5, 7

Cal. Corp. Code § 15045 (West 1977) 6

Cal. Prob. Code (West 1956):

Section 201 6
Section 202 5

Treasury Regulations on Income Tax (1954 Code) (26 C.F.R.):

Section 1.708-1(b)(1)(i) 4
Section 1.708-1(b)(1)(i)(*a*) 4
Section 1.708-1(b)(1)(iii)(*a*) 4

In the Supreme Court of the United States

OCTOBER TERM, 1982

No. 82-469

CAROLYN C. FIKE, EXECUTRIX OF THE ESTATE OF ERNEST D. SKAGGS, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

The question presented in this federal income tax case is whether the courts below correctly held that a two-member partnership did not terminate at the moment of one partner's death so that only the basis of the decedent's interest in the partnership, and not the bases of the underlying partnership assets, could be increased to date-of-death value under Section 1014 of the Internal Revenue Code of 1954 (26 U.S.C.).

The pertinent facts may be summarized as follows: Prior to December 31, 1973, Ernest and Carolyn Skaggs, husband and wife and residents of California, conducted a farming business as equal partners in a partnership known as the Santa Rita Ranch Company. Their partnership interests were held as community property. The partnership agreement provided that the partnership was to terminate upon the death of either partner, but also stated that the

estate of the deceased partner could then determine whether the partnership should elect to adjust the basis of partnership property pursuant to Section 754 of the Internal Revenue Code of 1954 (26 U.S.C.) (Pet. App. A-8 to A-9).

Ernest Skaggs died on December 31, 1973. All of the community property owned by decedent and Carolyn, including their partnership interests, became subject to probate administration. Carolyn was the sole beneficiary of decedent's will and executrix of his estate. It was essential to continue operation of the farming business after decedent's death in order to complete the 1973 crop season and to discharge outstanding partnership liabilities. Carolyn thereafter exercised full management control over the business by collecting accounts receivable, selling crops and beginning the preparation for the production of the next year's crops. The debts outstanding as of December 31, 1973, were paid from receipts collected between January 10, 1974, and September, 1974. No notice of dissolution of the partnership was ever published after decedent's death, and the farming business continued under the partnership name (Pet. App. A-9 to A-11).

On their 1974 tax returns, Carolyn and decedent's estate each reported one-half of the income and expenses derived from the farming operation in that year. In so doing, they assigned stepped-up bases, under Section 1014 of the Internal Revenue Code of 1954 (26 U.S.C.), to the crops sold and to the depreciable assets used in the business, reflecting the fair market value of those items on the date of decedent's death. On audit, the Commissioner of Internal Revenue rejected petitioners' proposed basis adjustments and increased taxable income for that year accordingly (Pet. App. A-11 to A-12).

The Tax Court upheld the Commissioner's determinations. It ruled that the death of decedent did not instantaneously terminate the partnership and that, since no

valid election was made under Section 754 of the Code, the base of the partnership assets could not be adjusted to reflect their fair market value on the date of Ernest's death (Pet. App. A-13 to A-32). The court of appeals affirmed[1] (Pet. App. A-1 to A-6).

1. The decision below correctly held that the partnership assets could not be assigned stepped-up bases reflecting their fair market value on the date of decedent's death under Section 1014(a) of the Code. That statute provides that property acquired or passed from a decedent may take a new basis equal to the date-of-death value of the property in question. Moreover, in the case of community property, this adjustment to basis also applies, under the provisions of Section 1014(b)(6), to the surviving spouse's share of the property in question. Pursuant to Section 743, however, where an interest in a partnership is transferred on the death of a partner, such a basis adjustment is permitted only with respect to the partnership interest itself, and not with respect to the underlying partnership assets unless the partnership makes the election provided for in Section 754.

Petitioners now acknowledge (Pet. 3) that the partnership did not make a valid Section 754 election.[2] They argue, however, that such an election was unnecessary on the theory that the partnership was immediately terminated and its assets distributed to Carolyn, as executrix of decedent's estate, at the moment of decedent's death and, therefore, the partnership assets—and not the decedent's partnership interest—were transferred to his estate for purposes of Sections 743(a) and 1014.

---

[1] The opinion of the court of appeals is reported at 672 F.2d 756.

[2] In the Tax Court, Carolyn and decedent's estate contended that a belated attempt to make an election under Section 754 should be honored. They did not renew that contention on appeal.

As the court of appeals noted (Pet. App. A-3 to A-4), however, the termination of a partnership for federal tax purposes is governed by Section 708 of the Code. Specifically, Section 708(b)(1)(A) provides that a partnership is considered to be terminated only if "no part of any business, financial operation, or venture of the partnership continues to be carried on by any of its partners in a partnership." See *Austin* v. *United States*, 461 F.2d 733, 737 (10th Cir. 1972); *Baker Commodities, Inc.* v. *Commissioner*, 415 F.2d 519, 526-527 (9th Cir. 1969), cert. denied, 397 U.S. 988 (1970). Similarly, Treasury Regulations on Income Tax (1954 Code), Sections 1.708-1(b)(1)(i) and (iii)(*a*) (26 C.F.R.), provide that, notwithstanding a dissolution, a partnership does not terminate for federal tax purposes until the winding up of partnership affairs has been completed. Thus, even upon the death of a partner in a two-member partnership, as here, the partnership is not effectively terminated as long as the estate of the deceased partner continues to share in the profits and losses of the partnership business. Treasury Regulations on Income Tax (1954 Code), Section 1.708-1(b)(1)(i)(*a*) (26 C.F.R.); *Haines* v. *United States*, 76-1 U.S. Tax Cas. para. 9222 (1976).

The facts in this case establish that the partnership here did not terminate at the moment of decedent's death. Between December 31, 1973, and, at the least, September 1974, Carolyn continued the farming business in order to discharge the partnership's outstanding obligations. Indeed, she apparently made no attempt to notify its customers or creditors that the business had undergone a change in form. Moreover, decedent's estate in its 1974 return treated as its own, one-half of the partnership income for that year. Since the estate continued to share in the profits of the business, the partnership did not terminate until some time after decedent's death.

2. The crux of petitioners' argument is that the decision below is nevertheless contrary to California law. Specifically, petitioners argue (Pet. 5-9) that upon Ernest's death only one person, i.e., Carolyn as executrix of his estate, had the legal right under California law to possess and use the partnership assets, and that the partnership must, therefore, have terminated at that time.

But there is no basis for inferring that Congress intended that the question of the continued existence of the partnership would be determined under state law when all other "termination" questions are to be determined under Section 708. See *Burnet* v. *Harmel*, 287 U.S. 103, 110 (1932) ("[s]tate law may control only when the federal taxing act, by express language or necessary implication, makes its own operation dependent upon state law."). In this respect, Section 708 specifically provides that it applies for the "purposes of this subchapter" (subchapter K encompassing Sections 701 through 761 of the Code) without exception.

At all events, the decision below is entirely consistent with California law. While all of the community property of Ernest and Carolyn (including their partnership interests) was subject to probate administration on decedent's death in accordance with California probate law then in effect,[3] it does not follow that the partnership was instantaneously terminated and all of its assets were thereupon distributed to decedent's estate. Indeed, to the contrary, it is clear that Carolyn's one-half of the community property, including

---

[3]During the period in question, Cal. Civ. Code § 5125 (West 1970) provided that the husband controlled the community personal property. In this respect, Cal. Prob. Code § 202 (West 1956), further provided that "Community property passing from the control of the husband * * * by reason of his death * * * is subject to debts and to administration and disposal under the provisions of Division III [Administration of Estates of Decedents] of this Code * * *."

her partnership interest, continued to belong to her individually and did not become part of decedent's estate. Cal. Prob. Code § 201 (West 1956). See *Bishop* v. *Commissioner*, 152 F.2d 389, 391 (9th Cir. 1945). Similarly, the fact that Carolyn managed the farming business as executrix of decedent's estate did not preclude her from acting, at the same time, on behalf of the surviving partnership. See *Keyes* v. *Hurlbert*, 43 Cal. App. 2d 497, 502, 111 P.2d 447, 450-451 (1941) ("When the surviving partner is also the personal representative of deceased, he acts in a dual capacity * * *."). In short, the authority vested in Carolyn as executrix did not limit her "rights and duties" as a surviving partner under California law. See Cal. Corp. Code § 15045 (West 1977).[4]

Finally, petitioners' contention (Pet. 9-11) that the decision below would require any husband-wife operated business in a community property state to be treated as a partnership is plainly wrong. The holding here, as the court of appeals noted (Pet. App. A-6), is limited to the case "where

---

[4]Contrary to petitioners' contentions (Pet. 8), neither the "termination" provision of the partnership agreement nor the order of the probate court stating that the partnership had terminated upon Ernest's death is of controlling significance here. While the partnership agreement stated that the partnership would terminate upon decedent's death, it also provided for his estate to elect under Section 754 whether the basis of the partnership property should be adjusted, thereby indicating that the partnership would continue for at least some purposes and for at least some time after decedent's death.

Moreover, as the Tax Court noted (Pet. App. A-27), the probate court's determination made in a nonadversarial context during the course of administering Ernest's estate was not intended to resolve (and indeed could not resolve) whether the partnership had terminated and whether the bases of its assets could be adjusted for federal tax purposes. See *Michigan Trust Co.* v. *Kavanagh*, 284 F.2d 502, 506 (6th Cir. 1960). See also *Commissioner* v. *Estate of Bosch*, 387 U.S. 456 (1967).

a husband and wife executed a formal partnership agreement." Ernest and Carolyn executed such an agreement in order to vest Carolyn with the legal authority to manage their farming business, which was otherwise prohibited to her under the applicable community property law then in effect. See Cal. Civ. Code § 5125 (West 1970). The fact that the law was later changed so as to allow both spouses to have equal management rights in community property (Cal. Civ. Code § 5125 (West Cum. Supp. 1982)) does not, of course, have any bearing on the question presented here as to continued existence of the partnership at the time of decedent's death.

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

REX E. LEE
Solicitor General

OCTOBER 1982

DOJ-1982-10